# Federal Interventions in Private Enterprise in the United States: Their Genesis in and Effects on Corporate Finance Instruments and Transactions

*Joan MacLeod Heminway*[*]

> "[D]ealmakers would do well to take a step back during this downturn and rethink their own strategy based on the lessons of the government's actions and recent events. Forms should be rethought and redrafted, and dealmakers should rethink fundamental deal structures and financing arrangements . . . ."[1]

## I. INTRODUCTION

Over the past few years, in response to an international financial meltdown, state governments intervened in economies all over the world. As a result, government and business are interconnected in more numerous ways than perhaps ever before. Governments have increased their regulatory control over businesses in financial services and other sectors; businesses assist governments in implementing regulation; and governments are directly and indirectly engaged in financing businesses that had been conducted through non-governmental entities.

The United States exemplifies this new public-private archetype.

> [E]ven as the . . . paradigm semi-nationalized some traditional private financial services in the United States, it also contributed to the privatization of government functions, which, during this period, were in many ways "run like a business" rather than as a

[*] College of Law Distinguished Professor of Law, The University of Tennessee College of Law; J.D., New York University School of Law; A.B., Brown University. I am indebted to Steve Davidoff and David Zaring, whose article, cited *infra* note 2, along with the follow-on book written by Steve, cited *infra* note 1, provided the impetus for this Article. In addition, each took time to read an earlier draft of this Article. I also owe thanks to George Kuney and Paul Harner, whose academic and practice backgrounds inform the included discussion of the Chrysler LLC and General Motors Company bankruptcy reorganizations.

[1] STEVEN M. DAVIDOFF, GODS AT WAR 298 (2009).

> regulator. The government was doing deals and taking stakes in profit-making institutions.[2]

This Article focuses on the U.S. government's engagement in and with corporate finance[3] as an example of this public-private engagement.

In response to U.S. corporate failures involved in the current global financial crisis, traditional corporate finance vehicles and tools were widely used in new ways and for new purposes.[4] Of course, one object of the U.S. government's investment and intervention in, and exercise of influence over, private enterprise during the crisis was to provide for or ensure the provision of adequate capital funding. But its investment, intervention, and influence also represented a new way to oversee and otherwise regulate key business enterprises in the financial services and automotive sectors. A pair of scholar-authors termed the phenomenon "regulation by deal."[5]

The flexibility of corporate finance instruments and transactions has been a hallmark of U.S. corporate law and practice, and in that sense, recent events are consistent with other chapters in the history of corporate finance in the United States. Nonetheless, it is important for us to look at recent public interventions in private enterprise not merely as a continuation of the past but also as different (and in some cases, new) breeds of corporate finance transaction—especially since the government is an explicit or implicit party. Moreover, strict scrutiny of these transactions may remind us of forgotten benefits to, and expose flaws in, existing transaction documents or structures.

The financial crisis-related transactions that illustrate these points are too numerous to cover here in full. A sampling of transactions, however, can begin to shed light on some of the corporate finance issues that arise from the U.S. government's recent investments, interventions, and influence in and over corporate finance. Accordingly, this Article reviews certain aspects of the use of preferred stock, bankruptcy-related proceedings, and mergers and acquisitions in connection with the government's recent, crisis-mode

---

[2] Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 468–69 (2009).

[3] The term "corporate finance" is used broadly and includes all instruments and transactions embodying or providing for the inflow, transformation, or utilization of capital in a business entity (e.g., corporation, LLC, etc.).

[4] DAVIDOFF, *supra* note 1, at 246 ("The government dealmakers and their lawyers used the enormous power of government to structure some truly novel deals that stretched the law to the breaking point at times.").

[5] *See* Davidoff & Zaring, *supra* note 2, at 463.

interventions in private enterprise. Further, it analyzes corporate finance aspects of these exploits and highlights potential effects of these activities on corporate finance instruments, transactions, and legal practice.

## II. REGULATION THROUGH PREFERRED STOCK PURCHASES

Beginning with its commitment to acquire a 79.9% voting and dividend interest in American International Group, Inc. (AIG) in September 2008,[6] the United States, acting through the Department of the Treasury, invested in newly designated and issued series of preferred stock in various financial services firms as part of its bailout plan. For example, as part of the Troubled Asset Relief Program (TARP), the U.S. Treasury invested in, among other iconic American banking corporations, Bank of America Corporation (BoA) and Citigroup Inc. (Citigroup), in addition to AIG.[7] The U.S. government purchased twenty billion dollars worth of preferred stock in BoA and Citigroup alone.[8]

The U.S. government's TARP investments replaced an earlier plan to bail out failing banks exclusively through the purchase of "mortgage-related assets."[9] Predictably, taxpayers and investors reacted adversely to this plan, which they perceived as both creating enhanced moral hazard and leaving the U.S. government (and, therefore, taxpayers) unprotected.[10] The U.S. government's preferred stock investments in financial services firms gave it a current, long-term financial and, to some extent, governance stake in the recovery of these systemically important firms. As a result, these investments curbed moral hazard and better protected U.S. government interests. Moreover, the preferred stock investments ranked ahead of the publicly traded common stock of these entities

---

[6] DAVIDOFF, *supra* note 1, at 257; Darla Mercado, *AIG Announces Preferred Stock Issue*, INVESTMENT NEWS, (Sept. 26, 2008, 6:13 PM), http://www.investmentnews.com/article/20080926/REG/809269948. A trust created for the benefit of the U.S Treasury made the AIG investment. *See* William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943, 964–65 (2009).

[7] OFFICE OF FIN. STABILITY, U.S. DEP'T OF THE TREASURY, REPORT: THE TROUBLED ASSET RELIEF PROGRAM (TARP) 7 (2009), *available at* http://www.financialstability.gov/docs/09%20OFS_CitizensReport%20MAR2.pdf.

[8] *Id.*

[9] *See* Edward V. Murphy & Baird Webel, *Proposal to Allow Treasury to Buy Mortgage-Related Assets to Address Financial Instability*, CONG. RESEARCH SERV., Sept. 22, 2008, at 2, *available at* http://fpc.state.gov/documents/organization/110286.pdf; *see also* DAVIDOFF, *supra* note 1, at 265.

[10] *See* Deborah Solomon et al., *U.S. to Buy Stakes in Nation's Largest Banks*, WALL ST. J., Oct. 14, 2008, at A1.

on the priority ladder, could be issued without shareholder approval, and could be constructed to have debt-like features. In sum, preferred stock was the most suitable available financial instrument for these investments and proved to be a flexible tool in the federal bailout.

This Part of the Article describes both the corporate authority to designate and issue the preferred stock that enabled the U.S. government to make these equity investments and significant terms and provisions of the preferred stock issued, using AIG, BoA, and Citigroup as key examples. The description of these facets of the government's preferred stock investments provides relevant legal details important to corporate finance practitioners and other key participants in capital-raising transactions. In addition, it illuminates the legal aspects of corporate finance that make preferred stock an advantageous investment vehicle in the bailout and in other capital investment situations.

### *A Blank Check Authority to Designate a Series of Preferred Stock*

AIG, BoA, and Citigroup are Delaware corporations.[11] The certificate of incorporation (or charter) for each corporation, as in effect on the date of the applicable preferred stock investment by the U.S. government, authorized the issuance of preferred stock (as well as common stock) and authorized its board of directors to designate different series of preferred stock and to determine the terms and provisions of those designated series.[12] This type of authority,

[11] *See* American International Group, Inc., Annual Report (Form 10-K/A) (Mar. 31, 2010), *available at* http://www.sec.gov/Archives/edgar/data/5272/000095012310030851/y83597e10vkza.htm; Bank of America Corporation, Annual Report (Form 10-K) (Feb. 26, 2010), *available at* http://www.sec.gov/Archives/edgar/data/70858/000119312510041666/d10k.htm; Citigroup Inc., Annual Report (Form 10-K) (Feb. 26, 2010), *available at* http://www.sec.gov/Archives/edgar/data/831001/000120677410000406/citi_10k.htm.

[12] *See* American International Group, Inc., Certificate of Incorporation Annual Report (Form 10-K), at Ex. 3(i) (Mar. 28, 1997), *available at* http://www.sec.gov/Archives/edgar/data/5272/0000950123-97-002720.txt [hereinafter AIG CoI]; Bank of America Corporation, Amended and Restated Certificate of Incorporation (Form 10-Q), at Ex. 3(a) (Nov. 6, 2008), *available at* http://www.sec.gov/Archives/edgar/data/70858/000119312508228086/dex3a.htm [hereinafter BoA CoI]; Citigroup Inc., Certificate of Incorporation Quarterly Report (Form 10-Q), at Ex. 3.01 (Nov. 12, 1998), *available at* http://www.sec.gov/Archives/edgar/data/831001/0001047469-98-040485.txt [hereinafter Citigroup CoI]; *see also* Sjostrom, *supra* note 6, at 977 ("AIG was and is able to issue the . . . preferred stock without stockholder approval in accordance with Delaware law because its authorized capital stock includes six million shares of 'Serial Preferred Stock" for which the board of directors is empowered, as contemplated by

permitted under section 151 of the General Corporation Law of the State of Delaware,[13] is known as "blank check authority," and the preferred stock authorized under that authority often is referred to as "blank check" preferred stock.[14]

Blank check authority to issue preferred stock allows a corporation to be more nimble in obtaining equity financing.[15] Absent blank check authority, a corporation must amend its certificate of incorporation in order to establish new classes or series of preferred stock,[16] and that amendment requires both board and stockholder votes under Delaware law.[17] Given the requirements that must be met under state and federal law in connection with a public company stockholder vote (e.g., advance notice of the meeting and the creation and filing of proxy materials), an amendment to a certificate of incorporation may take several months to accomplish.[18]

---

section 151(a) of Delaware General Corporation Law, to fix the rights, preferences, and limitations.").

[13] DEL. CODE ANN. tit. 8, § 151(a) (2010).

[14] *See* Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577, 609 (2003) ("Blank check preferred stock contains open terms that can be specified by the board at the time it is issued."); J. Robert Brown, Jr., *Speaking with Complete Candor: Shareholder Ratification and the Elimination of the Duty of Loyalty*, 54 HASTINGS L.J. 641, 644 n.12 (2003) ("Blank-check preferred stock provisions allowed management to issue new classes of shares without shareholder approval."); John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CAL. L. REV. 1301, 1357 (2001) (referencing "blank check" authority to issue preferred stock); John H. Matheson & Jon R. Norberg, *Hostile Share Acquisitions and Corporate Governance: A Framework for Evaluating Antitakeover Activities*, 47 U. PITT. L. REV. 407, 460 n.198 (1986) ("'Blank check' preferred is stock authorized by the shareholders, the rights and preferences of which may be determined by the board of directors at a later date.").

[15] *See* Matheson & Norberg, *supra* note 14, at 460 n.198 ("The ostensible purpose for a board to secure authorization for 'blank check' preferred stock traditionally was to give the board flexibility in securing financing for the corporation."). It also allows corporations other flexibility in using preferred stock—e.g., in fending off takeovers. *See, e.g.*, Coates, *supra* note 14, at 1357 (noting the use of blank check preferred stock as part of a poison pill device).

[16] DEL. CODE ANN. tit. 8, § 151(a) (2010).

[17] *Id.* § 242(b).

[18] The Delaware corporate law statute on the timing of notices for stockholder meetings reads as follows:

> Unless otherwise provided in this chapter, the written notice of any meeting shall be given not less than 10 nor more than 60 days before the date of the meeting to each stockholder entitled to vote at such meeting as of the record date for determining the stockholders entitled to notice of the meeting.

*Id.* § 222(b). The federal proxy rule on the filing of proxy materials provides that

> [f]ive preliminary copies of the proxy statement and form of proxy shall be filed with the Commission at least 10 calendar days prior to the

Accordingly, blank check authority was critical to the government's ability to quickly purchase stock in AIG, BoA, Citigroup, and other troubled corporations as part of its bailout strategy.[19]

The drafting of the blank check provision is different in each of the applicable certificates of incorporation. BoA's certificate of incorporation, in effect at the time the U.S. government invested, included a short, and seemingly limited, blank check authorization:

> The Board of Directors of the Corporation shall have full power and authority to establish one or more series within the class of preferred shares (the "Preferred Shares"), to define the designations, preferences, limitations and relative rights (including conversion rights) of shares within such class and to determine all variations between series.[20]

The BoA blank check provision does not track the language in section 151(a) of the General Corporation Law of the State of Delaware that permits the grant of blank check authority.[21] The statutory text allows for the board to establish, by resolution, a class or series of preferred stock having specified "voting powers, full or limited, or no voting powers, and . . . designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof."[22] The Delaware statute provides that the board's power to designate series of preferred stock arises from "authority *expressly* vested in it by the provisions of its certificate of incorporation."[23]

Notably, the BoA blank check provision fails to mention the authority to establish voting powers. The reference to "relative rights"[24] in the BoA provision may not cover voting powers because both terms are separately used in the statute and the statute does not indicate that voting powers are relative rights or that relative rights include voting powers. Moreover, the term "all variations between

---

> date definitive copies of such material are first sent or given to security holders, or such shorter period prior to that date as the Commission may authorize upon a showing of good cause thereunder.

17 C.F.R. § 240.14a-6(a) (2010). The proxy materials typically are distributed with the notice of meeting.

[19] *See* DAVIDOFF, *supra* note 1 at 257–58.

[20] BoA CoI, *supra* note 12.

[21] DEL. CODE ANN. tit. 8, § 151(a) (2010).

[22] *Id.* The same provision summarizes this list defining the scope of the board's permissive authority as the power to determine the "voting powers, designations, preferences, rights and qualifications, limitations or restrictions" of a class or series of preferred stock. *Id.*

[23] *Id.* (emphasis added).

[24] BoA CoI, *supra* note 12.

series"[25] in BoA's certificate of incorporation does not seem sufficient to expressly provide for board authority to designate a series of preferred stock including voting powers. The language in the blank check provision of BoA's certificate of incorporation, which fails to clearly, expressly authorize the board of directors to determine the voting powers of a series of preferred stock, is important; in *Waggoner v. Laster*,[26] the Delaware Supreme Court found that generalized text in a blank check charter provision was insufficient to grant the board of directors authority to establish voting powers in designating a series of preferred stock under Delaware law.[27] Despite the omission from the BoA certificate of incorporation of clear, express director authority to determine the voting powers of a series of preferred stock, the terms of the BoA preferred stock purchased by the U.S. government included voting rights.[28]

The blank check authority provisions for AIG and Citigroup are different and more detailed than that of BoA. Each certificate of incorporation includes a general grant of authority to the board of directors to designate and determine the terms and provisions of series of preferred stock. This general statement of authority is accompanied in each case by a nonexclusive list of authorized terms and provisions that more precisely defines the scope of the board's authority.[29] For example, each blank check provision authorizes the board to determine for each series: the distinctive designation number of shares, voting rights, dividend rights, redemption rights, conversion rights, and rights on liquidation or dissolution.[30] The language in the two certificates of incorporation defining these

---

[25] *Id.*

[26] 581 A.2d 1127 (Del. 1990).

[27] The court concluded as follows:

> The power to establish voting rights was conspicuously absent from the enumerated rights and powers granted the board. While that omission may have been accidental, given the requirements of Delaware law this Court cannot presume so and thereafter supply the missing provisions. Under the rule of strict construction, any ambiguity must be resolved against granting preferences, rights or powers.

*Id.* at 1135. Admittedly, the provision at issue in the *Waggoner* case also included language limiting voting rights to the common stockholders unless otherwise provided in the statute or in a resolution adopted by the board of directors, which is different from the more broad language in the BoA provision. *Id.* at 1130. The nature of any resolution approved by the board in *Waggoner* was unclear. *Id.* at 1132.

[28] *See infra* notes 54 & 55 and accompanying text. Earlier designated series of preferred stock also purportedly afford stockholders voting rights. *See* BoA CoI, *supra* note 12.

[29] *See* AIG CoI, *supra* note 12; Citigroup CoI, *supra* note 12.

[30] *Id.*

specific authorizations is, however, different in a number of respects not relevant here.[31] Moreover, in addition to the express authority afforded to the board to determine specific provisions, each blank check provision includes a catchall authorization allowing the board to determine, in AIG's case, "[a]ny other relative rights, preferences or limitations of the shares of the series not inconsistent herewith or with applicable law"[32] or, in the case of Citigroup, "[a]ny other relative, participating, optional or other special rights, qualifications, limitations or restrictions of that series."[33]

The risk of employing a detailed list of powers and rights in drafting blank check authority provisions for corporate charters is that by setting forth each feature of preferred stock that the board is authorized to determine, a corporation may inadvertently leave a desired feature of the preferred stock off the list or otherwise unintentionally limit the board's authority to establish the terms of a future class or series of preferred stock. To the extent that the omitted feature is not adequately covered by non-exclusivity provisions or a catchall provision, any designation by the board of directors of a new series of preferred stock with that feature would be unauthorized—*ultra vires*. The AIG certificate of incorporation and the Citigroup certificate of incorporation each include all of the key attributes of preferred stock set forth in the statute, although (as noted above) the precise wording for each is different from that for the other. While in each of these corporate charters (the AIG and Citigroup certificates of incorporation) the specific wording of each listed term (or attribute) is broad, individual facts may raise questions about the extent of the board's authority in providing for terms and provisions of a particular class or series of preferred stock.

Accordingly, although drafting in the AIG, BoA, and Citigroup certificates of incorporation did not impede the U.S. government's preferred stock investments, none of the blank check authorizations sampled here is optimally constructed. To offer a board the maximum flexibility in establishing a series of preferred stock and determining its terms and provisions and to forestall litigation over detailed lists regarding permitted terms (even if the lists are self-described as nonexclusive and are inclusive of a broad catchall provision), a drafter of blank check charter authority should use the precise words in the general blank check authority provision of the relevant corporate statute without embellishment. This type of blank

---

[31] *Id.*
[32] AIG CoI, *supra* note 12.
[33] Citigroup CoI, *supra* note 12.

check authority, a form of which is included in many certificates of incorporation for Delaware corporations, would read as follows:

> The corporation may issue Preferred Stock from time to time in one or more series as the Board of Directors may establish by the adoption of a resolution or resolutions relating thereto, each series to have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the resolution or resolutions providing for the issue of such series adopted by the Board of Directors pursuant to authority to do so, which authority is hereby granted to the Board of Directors.[34]

Of course, if the legislature amends the statute after the certificate of incorporation is filed, this approach may not continue to provide the all-inclusive authority intended by the drafter after the statutory amendment becomes effective. But statutory amendments also are likely to wreak similar havoc with other drafting approaches.

### *B. Stock Exchange Authority to Issue Preferred Stock*

State corporate authority was not the only authority needed to issue and sell preferred stock to the U.S. government as part of the federal financial bailout. Stock exchange rules applicable to listed companies also may govern the authority of a corporation in issuing preferred stock.[35] For example, the relevant rule of the New York Stock Exchange (NYSE)—on which AIG, BoA, and Citigroup each have listed securities—provides that, subject to certain exceptions not applicable to the U.S. government's preferred stock investments in AIG, BoA, or Citigroup,

[34] Honeywell International Inc., Amended and Restated Certificate of Incorporation (Form 8-K), at Ex. 3(i) (Apr. 26, 2010), *available at* http://www.sec.gov/Archives/edgar/data/773840/000093041310002190/c61318_ex3-i.htm. This provision includes the appropriate words from the statute, but could be drafted better in other respects (e.g., to economize on verbiage and to eliminate the use of "thereto" and "hereby").

[35] *See* NASDAQ STOCK MARKET RULES § 5635(d) (2009) *available at* http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp%5F1%5F1%5F4%5F2&manual=%2Fnasdaq%2Fmain%2Fnasdaq%2Dequityrules%2F; N.Y. STOCK EXCH. LISTED CO. MANUAL § 312.03 (2002), *available at* http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp%5F1%5F4%5F3&manual=%2Flcm%2Fsections%2Flcm%2Dsections%2F [hereinafter NYSE MANUAL]. The Model Business Corporation Act also includes a shareholder approval provision for large stock issuances. *See* MODEL BUS. CORP. ACT § 6.21(f) (2005), *available at* http://www.abanet.org/buslaw/library/onlinepublications/mbca2002.pdf.

> [s]hareholder approval is required prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction or series of related transactions if:
>
> (1) the common stock has, or will have upon issuance, voting power equal to or in excess of 20 percent of the voting power outstanding before the issuance of such stock or of securities convertible into or exercisable for common stock; or
>
> (2) the number of shares of common stock to be issued is, or will be upon issuance, equal to or in excess of 20 percent of the number of shares of common stock outstanding before the issuance of the common stock or of securities convertible into or exercisable for common stock.[36]

The rules, however, also include a provision allowing for exceptions from this shareholder approval requirement.

> Exceptions may be made . . . upon application to the Exchange when (1) the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise and (2) reliance by the company on this exception is expressly approved by the Audit Committee of the Board.
>
> A company relying on this exception must mail to all shareholders not later than 10 days before issuance of the securities a letter alerting them to its omission to seek the shareholder approval that would otherwise be required under the policy of the Exchange and indicating that the Audit Committee of the Board has expressly approved the exception.[37]

The U.S. government initially acquired convertible preferred stock in AIG representing, on an as-converted basis, 77.9% of the aggregate voting power of AIG's shares of common stock.[38] AIG relied on the exception to issue these shares of preferred stock.[39]

---

[36] NYSE MANUAL, *supra* note 35, at § 312.03(c). A similar exception exists under the NASDAQ Listing Rules. NASDAQ STOCK MARKET RULES §5635(f) (Mar. 15, 2010), *available at* http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp%5F1%5F1%5F4%5F2&manual=%2Fnasdaq%2Fmain%2Fnasdaq%2Dequityrules%2F.

[37] NYSE MANUAL, *supra* note 35, at § 312.05.

[38] American International Group, Current Report (Form 8-K), at Item 3.3 (Mar. 5, 2009), *available at* http://www.sec.gov/Archives/edgar/data/5272/000095012309004097/y75051e8vk.htm.

[39] Steven M. Davidoff, *The A.I.G. Bailout Takes Shape*, N.Y. TIMES DEALBOOK (Sept. 24, 2008, 9:32 AM), http://dealbook.blogs.nytimes.com/2008/09/24/the-aig-bailout-takes-shape.

However, AIG did not have enough underlying common stock to satisfy the conversion feature of the preferred stock.[40] As a result, AIG needed to seek stockholder approval for an amendment to its certificate of incorporation authorizing additional shares of common stock for issuance upon conversion of the preferred stock.[41] The certificate of designation for this series of preferred stock conditions the U.S. government's conversion rights on the filing of the amendment to AIG's certificate of incorporation.[42]

Exceptions from the stockholder approval requirement for large stock issuances generally are rare.[43] This is because it is hard to determine and prove that a "delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise."[44] The meanings of "seriously jeopardize" and "financial viability" in this context are not well established. Moreover, the NYSE does not publicize guidelines used by its representatives in responding to exemption requests.

---

[40] *See* Lawrence Cunningham, *AIG's Unsupervised Capital Structure Conflicts, Concurring Opinions* (Mar. 23, 2009, 11:52 PM), http://www.concurringopinions.com/archives/2009/03/aigs_unsupervis_1.html ("AIG's charter authorizes it to issue only 5 billion common shares and 3 billion of those already are outstanding. That does not leave enough common shares to enable the preferred to be converted so that it would command more than 40% of the total voting power."); Steven M. Davidoff, *Sizing up A.I.G.'s New Bailout*, N.Y. TIMES DEALBOOK (Nov. 10, 2008, 10:48 AM), http://dealbook.blogs.nytimes.com/2008/11/10/sizing-up-aigs-new-bailout/ (describing the need for shareholder approval of additional authorized shares to cover commitments under the preferred stock). *Cf.* American International Group, Inc., Current Report (Form 8-K), at Item 1.01 (Sept. 26, 2008), http://www.sec.gov/Archives/edgar/data/5272/000095012308011496/y71452e8vk.htm (indicating that the preferred shares would not be convertible until shareholder approval for the underlying common shares is received).

[41] American International Group, Inc., Proxy Statement (Schedule 14A) (June 5, 2009), *available at* http://www.sec.gov/Archives/edgar/data/5272/000093041309003116/c57286_def14a.htm; *see* DAVIDOFF, *supra* note 1, at 258.

[42] American International Group, Inc., Amended and Restated Certificate of Incorporation (Form S-3), at Ex. 3(i)(a) (June 30, 2009), *available at* http://www.sec.gov/Archives/edgar/data/5272/000095012309023187/y75649exv3wiwa.htm.

[43] *See* Melissa Klein Aguilar, *Mutual Recognition; NYSE Shareholder Approval; More*, COMPLIANCE WEEK, (Apr. 8, 2008), http://www.complianceweek.com/article/4066/mutual-recognition-nyse-shareholder-approval-more (referring to the exception as "rarely used" and "infrequently utilized").

[44] *See* NYSE MANUAL, *supra* note 35 and accompanying text.

Since 2008, however, AIG and other issuers of securities have successfully availed themselves of the financial viability exception.[45] The significant number of successful applications for exceptions during the financial crisis, while not precedential, offers future issuers in corporate finance transactions a series of realistic models for use in decision-making and drafting. Although the exact circumstances of the financial crisis are unlikely to recur in the future, the exceptions granted during the crisis help both issuers and the NYSE identify various coexisting conditions that may warrant an exception in similar economic times or for analogous issuers. Advisors have begun to recognize the value of the increased use of the exception, resulting in at least one firm publicizing guidelines for use of the exemption by issuers.[46]

### C. *Terms and Provisions of Preferred Stock Issued to the U.S. Government*

The U.S. government purchased or otherwise acquired multiple series of preferred stock in AIG, BoA, and Citigroup as part of the federal bailout of financial services firms.[47] These series of preferred stock have varied terms and provisions based on their purpose in the bailout of each issuer, the constraints on each issuer (including, for example, capital requirements for the bank issuers and other regulatory restrictions on the issuers), parameters set by the U.S. government, as the investor, and the negotiations between the government and each issuer. Moreover, the U.S. government's initial

[45] Aguilar, *supra* note 43 ("In the first week of March, MoneyGram, Bear Stearns, Thornburg Mortgage, and AbitibiBowater all announced or closed investments in reliance on the provision.").

[46] *See* Sanjay Shirodkar & Michael Reed, *How to Do a Deal Without Shareholder Approval: The Financial Viability Exception*, NEWS & INSIGHTS, DLA PIPER, July 28, 2008, *available at* http://www.dlapiper.com/financial_viability_exception.

[47] *See* American International Group, Inc., Annual Report (Form 10-K), at 21 (Feb. 26, 2010), *available at* http://www.sec.gov/Archives/edgar/data/5272/000104746910001465/a2196553z10-k.htm (mentioning the beneficial interest of the U.S. Department of the Treasury in the Series C Perpetual, Convertible, Participating Preferred Stock); *id.* at 311 (mentioning the U.S. Department of the Treasury's ownership of Series D, Series E, and Series F preferred Stock); Bank of America Corporation, Form 10-K at 53) (Feb. 26, 2010), *available at* http://www.sec.gov/Archives/edgar/data/70858/000119312510041666/d10k.htm (mentioning the U.S. Department of the Treasury's ownership of Cumulative Perpetual Preferred Stock Series N, Series Q, and Series R); Citigroup Inc., Annual Report (Form 10-K), at 192 (Feb. 26, 2010), *available at* http://www.sec.gov/Archives/edgar/data/831001/000120677410000406/citi_10k.htm (mentioning the U.S. Department of the Treasury's ownership of Series H and Series I Cumulative Preferred Stock).

investments occurred over time in several tranches, and as a result, each party (investor and issuer) has had the opportunity to refine its purposes as the investments have evolved.[48] The various terms of each series are too numerous to set out in full here, but the nature and extent of the variations are easily illustrated by summarizing a few of the provisions from the early preferred stock issuances.

As in corporate finance transactions generally, there are tensions among the terms and provisions of each security between enabling the issuer to survive and (hopefully) thrive and enabling the investor(s) to make an adequate return and exercise some governance control over the issuer and the investment. In distressed investment situations like this, the investor typically "holds the cookie"—the bargaining leverage or power; the investor has what the issuer desperately wants. Unlike some corporate finance transactions, however, the negotiations over the U.S. government's preferred stock investments and their outcome were all quite public, and the interested investor base included not only the U.S. government, as the record holder, but also U.S. taxpayers. These factors undoubtedly changed the nature of the negotiations and, in turn, the nature of the securities themselves.

The summary of sample terms in the U.S. government's preferred stock instruments set forth below underscores a very important part of preferred stock as an instrument of corporate finance—its flexibility as a statutorily ordained and contractually implemented form of equity investment. When properly authorized and implemented, leaving aside tax considerations (which often play a strong role in the debt-versus-equity debate), preferred stock—especially convertible preferred stock—may be an optimal instrument of corporate finance in certain corporate finance contexts. Both equity-oriented and debt-like terms can be combined in the same instrument—an instrument well grounded in both statutory law and the corporate charter. Issuer and investor interests can be delicately balanced, and seemingly infinite possibilities for combinations and contents of provisions exist. Note, as you read through the summary below, the convergence and divergence of basic terms in even these few sample securities.

---

[48] *See generally* Lissa L. Broome, *Government Investment in Banks: Creeping Nationalization or Prudent, Temporary Aid?*, 4 FLA. INT'L U. L. REV. 409, 410–21 (2009) (describing the actual and potential phases of the government bailout of U.S. banking institutions).

1. Voting Rights

Voting rights are present in all of the series of preferred stock AIG, BoA, and Citigroup issued to the U.S. government.[49] Generally, each share of AIG Series C Perpetual, Convertible, Participating Preferred Stock has the same number of votes it would have if it were converted into common stock and votes together with the common stock.[50] The shares of AIG Series D Fixed Rate Cumulative Perpetual Preferred Stock, however, have special class voting rights, including watchdog director election rights[51] in the event of a dividend arrearage of four quarters and entitlement to a 66 □ % supermajority vote on: the authorization of senior and *pari passu* equity; amendments to the terms of the Series D Fixed Rate Cumulative Perpetual Preferred Stock or the certificate of incorporation that adversely affect the shares of the series; and share exchanges, reclassifications, mergers, and consolidations (subject to certain exceptions).[52] Each holder is "entitled to one vote for each $10,000 of liquidation preference to which such holder's shares are entitled."[53] The shares of BoA Fixed Rate Cumulative Perpetual Preferred Stock, Series N, have watchdog director election rights in the event of a dividend arrearage of six quarters and entitlement to a 66 □ % supermajority vote on: the authorization of senior (but not *pari passu*) equity; amendments to the terms of the Fixed Rate Cumulative Perpetual Preferred Stock, Series N, or the certificate of incorporation that adversely affect the shares of the series; and share exchanges, reclassifications, mergers, and consolidations (subject to

[49] For a general discussion of voting rights in the U.S. government's TARP investments, see Benjamin A. Templin, *The Government Shareholder: Regulating Public Ownership of Private Enterprise*, 62 ADMIN. L. REV. (forthcoming 2010), *available at* http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1636491_code348985.pdf?abstractid=1636491&mirid=1.

[50] *See* American International Group, Inc., Certificate of Designations of Series C Perpetual, Convertible, Participating Preferred Stock (Form 10-Q), at Ex. 3(i)(a) (May 7, 2009), *available at* http://www.sec.gov/Archives/edgar/data/5272/000095012309008272/y76976exv3wiwa.htm [hereinafter AIG Series C CoD].

[51] "Watchdog" directors in this context are directors elected by shareholders of a class or series ostensibly to provide a monitoring function during a period of significant dividend arrearages, as defined in the terms of the preferred stock. *See* RICHARD T. MCDERMOTT, LEGAL ASPECTS OF CORPORATE FINANCE 345 (4th ed. 2006).

[52] *See* American International Group, Inc., Certificate of Designations of Series D Fixed Rate Cumulative Perpetual Preferred Stock (Form 8-K), at Ex. 3.1 (Nov. 24, 2008), *available at* http://www.sec.gov/Archives/edgar/data/5272/000095012308016447/y72888exv3w1.htm [hereinafter AIG Series D CoD].

[53] *Id.*

certain exceptions).[54] Each share affords the holder one vote.[55] Shares of the Citigroup Fixed Rate Cumulative Perpetual Preferred Stock, Series I, have watchdog director election rights in the event of a dividend arrearage of six quarters and entitlement to a 66⅔% supermajority vote on: the authorization of senior (but not *pari passu*) equity; amendments to the terms of the Fixed Rate Cumulative Perpetual Preferred Stock, Series I, or the certificate of incorporation that adversely affect the shares of the series; and share exchanges, reclassifications, mergers, and consolidations (subject to certain exceptions).[56] These voting rights are like those for the BoA Fixed Rate Cumulative Perpetual Preferred Stock, Series N.[57] Yet each holder is "entitled to one vote for each $10,000 of liquidation preference to which such holder's shares are entitled,"[58] like the holders of shares of the AIG Series D Fixed Rate Cumulative Perpetual Preferred Stock.[59]

2. Conversion Rights

Although the AIG Series C Perpetual, Convertible, Participating Preferred Stock includes a conversion privilege exercisable at the option of the U.S. government,[60] shares of the AIG Series D Fixed Rate Cumulative Perpetual Preferred Stock,[61] BoA Fixed Rate Cumulative Perpetual Preferred Stock, Series N,[62] and Citigroup Fixed Rate Cumulative Perpetual Preferred Stock, Series I,[63] are not convertible. Optional conversion features in preferred stock that permit investors to convert their preferred equity position into common stock (like those included in the AIG Series C Perpetual, Convertible, Participating Preferred Stock) offer investors the

---

[54] *See* Bank of America Corporation, Certificate of Designations for the Series N Preferred Stock (Form 8-K), at Ex. 3.1 (Oct. 30, 2008), *available at* http://www.sec.gov/Archives/edgar/data/70858/000119312508220360/dex31.htm [hereinafter BoA Series N CoD].

[55] *Id.*

[56] *See* Citigroup Inc., Certificate of Designations of Fixed Rate Cumulative Perpetual Preferred Stock, Series I (Form 8-K), at Ex. 3.1 (Dec. 31, 2008), *available at* http://www.sec.gov/Archives/edgar/data/831001/000095010308003069/dp12158_ex0301.htm [hereinafter Citigroup Series I CoD].

[57] *See supra* note 54 and accompanying text.

[58] *See* Citigroup Series I CoD, *supra* note 56.

[59] *See supra* note 52 and text accompanying note 53.

[60] *See* AIG Series C CoD, *supra* note 50.

[61] *See* AIG Series D CoD, *supra* note 52.

[62] *See* BoA Series N CoD, *supra* note 54.

[63] *See* Citigroup Series I CoD, *supra* note 56.

opportunity to trade their preferred position in terms of dividends and liquidation for the more liquid, market-based upside potential of the common stock on specified terms and under specified conditions.[64] This general type of conversion provision is distinguishable from mandatory conversion provisions commonly used in venture capital preferred stock instruments, which operate to automatically divest investors from their preference rights upon the occurrence of a specific event (commonly an initial public offering or a change-in-control transaction).[65]

3. Redemption Rights

Shares of the AIG Series C Perpetual, Convertible, Participating Preferred Stock are not redeemable.[66] Shares of the AIG Series D Fixed Rate Cumulative Perpetual Preferred Stock are redeemable at a redemption price equal to the shares' liquidation preference plus, subject to certain exceptions, the amount of any accrued and unpaid dividends under certain specified circumstances involving a lack of control of AIG by the U.S. government.[67] Shares of BoA Fixed Rate Cumulative Perpetual Preferred Stock, Series N, may not be redeemed prior to the first dividend payment date falling on or after the third anniversary of the date the shares were originally issued (subject to certain exceptions), but may be redeemed after that time under specified conditions relating to bank authority approvals at a redemption price equal to the shares' liquidation preference plus (subject to certain exceptions) the amount of any accrued and unpaid dividends.[68] And finally, shares of Citigroup Fixed Rate Cumulative Perpetual Preferred Stock, Series I, may be redeemed under specified conditions relating to bank authority approvals on or after the date on which the shares of the Citigroup Fixed Rate Cumulative Perpetual Preferred Stock, Series H, have been redeemed, at a redemption price equal to the shares' liquidation

[64] *See* Marcel Kahan, *Anti-Dilution Provisions in Convertible Securities*, 2 STAN. J.L. BUS. & FIN. 147, 147 (1995); John L. Orcutt, *Improving the Efficiency of the Angel Finance Market: A Proposal to Expand the Intermediary Role of Finders in the Private Capital Raising Setting*, 37 ARIZ. ST. L.J. 861, 892-93 (2005).

[65] *See* Ronald J. Gilson & David M. Schizer, *Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock*, 116 HARV. L. REV. 874, 881 n.26, 882 (2003).

[66] *See* AIG Series C CoD, *supra* note 50.

[67] *See* AIG Series D CoD, *supra* note 52.

[68] *See* BoA Series N CoD, *supra* note 54.

preference plus (subject to certain exceptions) the amount of any accrued and unpaid dividends.[69]

4. Dividend Rights

Dividends are payable on the shares of the AIG Series C Perpetual, Convertible, Participating Preferred Stock together with dividends paid on AIG's common stock.[70] Dividends also are payable on the AIG Series D Fixed Rate Cumulative Perpetual Preferred Stock, BoA Fixed Rate Cumulative Perpetual Preferred Stock, Series N, and Citigroup Fixed Rate Cumulative Perpetual Preferred Stock, Series I, but at specified rates and on specified dates.[71] Dividends on these three series are cumulative.[72] "Cumulative rights to dividends means that if the business misses dividend payments to the preferred stockholders, the preferred stockholder has the right to receive back (missed) dividends plus the current dividend before any dividends are paid to the common stockholders."[73]

5. Preferred Stock as a Flexible, Contractual Instrument

Even this brief summary of several of the key terms and provisions of the various series of preferred stock issued to or for the benefit of the U.S. government shows the incredible flexibility and range of preferred stock as an instrument in corporate finance. "[T]he terms of preferred stock are defined by contracts that may have infinite variations on the theme."[74] As we can see from the varied terms of each exemplar series described in the preceding paragraphs, preferred stock is highly contractual,[75] with few

---

[69] *See* Citigroup Series I CoD, *supra* note 56.

[70] *See* AIG Series C CoD, *supra* note 50.

[71] *See* AIG Series D CoD, *supra* note 52; BoA Series N CoD, *supra* note 54; Citigroup Series I CoD, *supra* note 56.

[72] AIG Series D CoD, *supra* note 52; BoA Series N CoD, *supra* note 54; Citigroup Series I CoD, *supra* note 56.

[73] Richard A. Mann et al., *Starting From Scratch: A Lawyer's Guide To Representing A Start-Up Company*, 56 ARK. L. REV. 773, 819 (2004). "Non-cumulative preferred stock means that the preferred stockholder loses dividend payments for any year in which no dividends were paid." *Id.* *See also* Michael A. Woronoff & Jonathan A. Rosen, *Effective vs Nominal Valuations in Venture Capital Investing*, 2 N.Y.U. J. L. & BUS. 199, 217 (2005) ("If a dividend is non-cumulative it is not due unless declared. If not declared for a particular period, the company owes no dividends for that period. Because boards are unlikely to declare a dividend when not required to, 63 non-cumulative dividends will typically not alter effective valuations.").

[74] D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, n.296 (2002).

[75] Wood v. Coastal States Gas Corp., 401 A.2d 932, 937 (Del. 1979) ("For most purposes, the rights of the preferred shareholders as against the common

constraints placed on it by the state corporate statutes that authorize its use.[76]

> Preferred stock comes in many guises, and no single Platonic form underlies its variety. Whatever its attributes (its "rights, preferences, and privileges," in the jargon), preferred stock is quintessentially a matter of contract. If any deviation from the attributes of the residual common stock concept is desired, the contract must specify it. Of course this is only an imaginary situation. Preferred stock not only needs to be defined by contract, it is defined by contract—by definition, one is tempted to say.[77]

The terms and provisions of a class or series of preferred stock are and must be respectfully treated as a legally binding contract: it is the drafter's responsibility to use this tool creatively and flexibly in the service of client needs, and it is the courts' responsibility to interpret the drafter's work product when its provisions are subject to challenge.[78] Focused, comprehensive study of the terms and provisions of the various series of preferred stock acquired by the

---

shareholders are fixed by the contractual terms agreed upon when the class of preferred stock is created."); Rothschild Int'l Corp. v. Liggett Grp., Inc., 463 A.2d 642, 646 (Del. Ch. 1983) ("The preferential rights attaching to shares of preferred stock are contractual in nature and are governed by the express provisions of a corporation's charter."); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1564 (1989) ("[S]enior securities, both debt and preferred stock, . . . frequently contain complicated contractual provisions relating to the circumstances of voting, representation on the board of directors, conversion into common stock, call protection, redemption exposure, dilution and other such concerns.").

[76] *See, e.g.*, DEL. CODE ANN. tit. 8, § 151 (2010).

[77] Richard M. Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CALIF. L. REV. 1671, 1684 (1985).

[78] Former Delaware Supreme Court Chief Justice Veasey made precisely this point and expanded on its meaning in a seminal corporate finance case:

> Articulation of the rights of preferred stockholders is fundamentally the function of corporate drafters. Construction of the terms of preferred stock is the function of courts. This Court's function is essentially one of contract interpretation against the background of Delaware precedent. These precedential parameters are simply stated: Any rights, preferences and limitations of preferred stock that distinguish that stock from common stock must be expressly and clearly stated, as provided by statute. Therefore, these rights, preferences and limitations will not be presumed or implied. The other doctrine states that when there is a hopeless ambiguity attributable to the corporate drafter that could mislead a reasonable investor such ambiguity must be construed in favor of the reasonable expectations of the investor and against the drafter.

Elliott Assocs., L.P. v. Avatex Corp., 715 A.2d 843, 852–53 (Del. 1998) (footnotes omitted).

U.S. government in the federal bailout—or any other grouping of similarly situated securities—reminds corporate finance counsel of the intricacies involved in drafting preferred stock and is sure to lead drafters of corporate finance instruments to new insights about the instruments that they draft in order to bring capital into the corporation.

## III. REGULATION THROUGH INTERVENTION IN BANKRUPTCY REORGANIZATIONS

The U.S. government's crisis regulation through corporate finance extended beyond mere capital investment, however, and into the realm of leverage over quasi-judicial process and transaction partners and terms in the bankruptcy setting. Specifically, the government used its position as an investor-regulator to intervene in arrangements for the bankruptcy reorganizations of Chrysler LLC (Chrysler) and General Motors Company (GM). The government's intervention shaped both the speed and certainty of these reorganizations.

Chapter 11 bankruptcies often result in both the disruption of existing capital structures of a business association and the consummation of significant corporate finance transactions. In a reorganization under Chapter 11, for example, the entire capital structure of an entity may be altered by court order, or the corporation's assets may be sold to a new owner.[79] Existing security holders may have little say in all this and may have their equity interests cancelled under the plan of reorganization pursuant to the "absolute priority rule."[80] The debtor in possession's power of the pen (subject to court approval) is staggering, allowing it to overwrite carefully crafted terms in corporate finance instruments and ordain the terms and provisions of corporate finance transactions.[81]

Both Chrysler and GM entered and exited bankruptcy in six weeks or less—forty-two days for Chrysler and forty days for GM. In

---

[79] *See* 11 U.S.C. §§ 363, 1123, 1129 (2006). For a discussion of both the plan-focused reorganization apparently contemplated by the drafters of the Bankruptcy Code and the § 363 asset sale process that has evolved in practice, see George W. Kuney, *Misinterpreting Bankruptcy Code § 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L.J. 235 (2002) [hereinafter Kuney, *Misinterpreting*].

[80] *See* 11 U.S.C. § 1129(b)(2) (absolute priority rule).

[81] *See* 11 U.S.C. § 1123 (a)–(b) (specifying what a plan shall and may provide for, including "merger or consolidation of the debtor with one or more persons; . . . cancellation or modification of any indenture or similar instrument; . . . extension or a maturity date or a change in an interest rate or other term of outstanding securities; . . . amendment of the debtor's charter").

each case, the U.S. government used its leverage as a powerful regulator/investor to prompt and shape a particular outcome.[82] "Beyond their massive size, the automakers' bankruptcies were remarkable for the active role of the federal government in encouraging the filings and charting the course of the proceedings—circumstances leading to concerns that their bankruptcy cases were unduly influenced by political actors."[83] Scholars now debate whether this political intervention in business is extraordinary or desirable.[84]

Undoubtedly, the Chrysler and GM bankruptcies represent significant corporate finance events. Both entities quickly emerged from bankruptcy reorganizations with different owners and capital structures. In each case, the failure to fully respect the absolute priority rule and the priority ladder (by, for example, shorting the Indiana Teachers Pension Fund, a secured creditor, in favor of the GM Pension Fund, a junior unsecured creditor and equity holder) may increase uncertainty in the priority system and make investors less willing to invest, as the terms of their deal may be unilaterally changed in a Chapter 11 reorganization plan. It is important to question whether the costs of this strategy and the related tactics are so high that they have a deleterious effect on capital markets. Does the overt or subtle favoring of some parties over others in a bankruptcy like the Chrysler or GM bankruptcies create such an unpalatable impression of unfairness that investment will be discouraged?

Both the Chrysler and GM bankruptcies were conducted as asset sales under § 363 of the U.S. Bankruptcy Code ("§ 363 sales").[85] According to certain commentators, although the U.S. Bankruptcy Code is not clear on the requirements for § 363 sales in this context,

---

[82] *See* John E. Kwoka, Jr., *The U.S. Auto Industry Under Duress: Fit, or Finished?*, 5 COMPETITION POL'Y INT'L 49, 68–69 (2009) (describing the two bankruptcies); George W. Kuney, *Vacating* Chrysler, 19 NORTON J. BANKR. L. & PRAC. 2 Art. 1 (2010) (providing a critique of the Chrysler bankruptcy) [hereinafter Kuney, *Vacating* Chrysler]; Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531 (2009) (assessing both bankruptcies); Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727 (2010) (criticizing the process of the Chrysler bankruptcy).

[83] Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 STAN. L. REV. 747, 749 (2010). *See also* Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648, 696 (2010) ("The bankruptcies of both GM and Chrysler were able to proceed at breakneck pace because one player—the United States government—was able to dictate the terms of the proceedings.").

[84] *Compare* Lubben, *supra* note 82, *with* Roe & Skeel, *supra* note 82 (arguing these points).

[85] 11 U.S.C. § 363 (2006). Professor Lubben has included a helpful summary of the two Chapter 11 proceedings in his article cited *supra* note 82, at 536–39.

the Chrysler and GM § 363 sales failed to rigorously enforce applicable procedures designed to protect investors from or in the event of a loss of priority in a reorganization plan.[86] A brief description of the two bankruptcy processes is in order. As described by Professors Mark Roe and David Skeel (in the case of the Chrysler bankruptcy):

> The deal's basic structure is straightforward to summarize. Prebankruptcy, Chrysler was a private firm, owned by Cerberus, a large private equity fund. As of the bankruptcy, its two largest creditors were secured creditors owed $ 6.9 billion and an unsecured employee benefit plan, owed $ 10 billion. It also owed trade creditors $ 5.3 billion, and it had warranty and dealer obligations of several billion dollars.
>
> The government created and funded a shell company that, through a § 363 sale from Chrysler, bought substantially all of Chrysler's assets for $ 2 billion, giving the secured creditors a return of 29 cents on the dollar. FIAT was brought in to manage the new firm and was given a slice of the new company's stock. New Chrysler (formally: New CarCo Acquisition LLC) then assumed the old company's debts to the retirees, most dealers, and trade creditors. The $ 10 billion of unsecured claims owed to the retirees' benefits plan were replaced with a new $ 4.6 billion note as well as 55 percent of the new company's stock.[87]

The result?

> Priority seemed violated. Unsecured retiree claims were promised well over 50 cents on the dollar, along with control of the New Chrysler, and unsecured trade creditors were promised full payment. The secured creditors, however, were getting 29 cents on the dollar, and future products-liability claims relating to Chrysler cars already on the road would receive nothing at all under the plan, as the pseudo-sale made no provision for them. Claims could be brought against only Old Chrysler, which was expected to soon have no assets.[88]

---

[86] *See* Kuney, *Vacating* Chrysler, *supra* note 82, at 127; Roe & Skeel, *supra* note 82, at 733–34, 770. Professors Roe and Skeel analyze the entire structure of the transaction in detail in the body of their article. *Id.* at 734–51.

[87] Roe & Skeel, *supra* note 82, at 733 (footnotes omitted); *see also* Templin, *supra* note 49, at 42–45.

[88] *Id.*; *see also* Templin, *supra* note 49, at 43 ("[T]he Obama administration's strategy was largely criticized because it interfered with the contractual rights of the bondholders by favoring unions in the post-bankruptcy ownership. The pre-planned bankruptcy plan advocated by the Obama Administration created a post-bankruptcy ownership structure that favored the union-driven employment retirement funds rather than bondholders.") (footnote omitted).

The GM bankruptcy, while more mainstream in some respects than the Chrysler Chapter 11 proceedings, was built off the same model.

> The government used the same template for the § 363 sale in GM as it did in *Chrysler*. As in *Chrysler*, the buyer was not a true third party, the ostensible immediacy to the urgency of the sale was debatable, and the § 363 bidding procedures required that would-be bidders agree to the retiree settlement negotiated by the government and GM. But GM's secured creditors, unlike their counterparts in *Chrysler*, were paid in full. The GM sale was in this dimension thus easier to reconcile with ordinary priority rules than *Chrysler*.[89]

The difference in the two cases is important. In the Chrysler proceedings, the retirees and trade creditors got more, out of priority, because the purchaser needed them to complete the transaction. Conversely, the purchaser made a calculated judgment that it could treat secured creditors and tort claimants in an inferior manner and still complete the reorganization. It may well be that Chrysler would have failed absent this disparate treatment. The same type of disparate treatment did not occur in the GM Chapter 11 reorganization.

Yet these differences do not combat fears that the aberrant and flawed abbreviated § 363 sale process used in the Chrysler bankruptcy or the short-form process used in the GM bankruptcy will be used in future Chapter 11 proceedings with similarly unfair or less fair results.[90] Professors Roe and Skeel note that the § 363 sale process used in the Chrysler bankruptcy "sharply cut off" two creditor groups and contend that the process affected capital markets by rewriting, through the bankruptcy court's actions, the essence of the Chapter 11 reorganization provisions in the U.S. Bankruptcy Code.[91] The

---

[89] Roe & Skeel, *supra* note 82, at 765.

[90] *See Id.* at 731; *see also* Kuney, *Vacating* Chrysler, *supra* note 82, at 131 ("[T]he Second Circuit's Chrysler opinion had already been used to support confirmation of a similar, but less draconian, section 363 transaction in the *General Motors* reorganization case and was being cited in support of similar, fast-track reorganization-by-sale transactions elsewhere."); *id.* at 130–31 (discussing the effect of the Supreme Court opinion vacating the Second Circuit's opinion in the *Chrysler* case).

[91] *See* Roe & Skeel, *supra* note 82, at 729. In their conclusion, Professors Roe and Skeel again articulate this relationship between the rules of the road in a Chapter 11 reorganization and the capital markets.

> For minority creditors, there's a century of bankruptcy and equity-receivership law designed to balance protection from the majority's potential to encroach on the minority and squeeze them out from their contractual priority against the minority's potential to hold out

significant increase in volume of § 363 sales over the past ten to fifteen years,[92] together with pre-existing related process erosions in the Chapter 11 context,[93] certainly gives reason to reflect on the possibility that Chrysler-type § 363 sales may proliferate. If Professors Roe and Skeel and other like commentators are right (that the Chrysler and GM bankruptcies represent a new form of abuse likely to be repeated), now is the time to prevent the identified abuses of process through legislation or judicial action.[94]

Professor Stephen Lubben contests the negative views of Professors Roe and Skeel (and others) on the Chrysler and GM § 363 sales and argues that the two § 363 sales were conducted in the ordinary course of bankruptcy practice:

> [T]he basic structure used to reorganize both GM and Chrysler was not unprecedented. Indeed, it was entirely ordinary. In both cases the "good" assets were sold to new entities. The consideration for that sale goes to the "old" debtor, and will be distributed according to the absolute priority rule. None of this constitutes a covert reorganization plan or a corruption of the bankruptcy process.[95]

Essentially, Professor Lubben argues that the Chrysler and GM § 363 sales represent business as usual in a Chapter 11 setting, in which there are limited prospects for saving the debtor from liquidation. True enough. A debtor in bankruptcy admittedly has limited choices if it desires to remain extant. In fact, Professor Lubben's argument, a more positive view, may be in line with the majority position.

---

> perniciously. These are neither small nor simply fairness-based considerations: capital markets depend on effective mechanisms that prevent financial majorities from ousting financial minorities from their ratable position in an enterprise.

*Id.* at 771.

[92] *See* Lubben, *supra* note 82, at 535.

[93] *See* Kuney, *Misinterpreting*, *supra* note 79, at 235. Professor Kuney observes:

> Seemingly slight misinterpretations can dramatically alter an entire statutory scheme. Like small cracks along a rock face, these slight imperfections provide toeholds for roots, ice, wind and water that will eventually erode the entire surface. Courts faced with interpretation of Bankruptcy Code § 363(f) prove this to be all too true. Multiple misinterpretations of this subsection of the Code have been repeatedly committed.

*Id.*

[94] *See* Roe & Skeel, *supra* note 82, at 771 ("Going forward, the extent of *Chrysler*'s damage to bankruptcy practice and financial markets will depend either on congressional action or on how *Chrysler* is construed by other courts, and whether they will limit its application, as they should.").

[95] Lubben, *supra* note 82, at 538 (footnotes omitted).

However, the incremental process erosions observed by critics of § 363 sales may be slowly and invidiously creating a new sense of the ordinary course—a set of circumstances that merits attention.

In fact, a close reading of Professor Lubben's work is not inconsistent with this slippery slope argument. In a recent piece for *The New York Times DealBook*, he describes a more recent § 363 sale (for Claim Jumper Restaurants, LLC) proposed to be completed in a compacted time frame.[96] He sees this as more evidence that Chrysler and GM represent mainstream Chapter 11 proceedings, concluding that "[u]ltimately, only Congress can decide if this is a proper use of Chapter 11 of the Bankruptcy Code."[97] In closing, he then reaffirms that "Chrysler and G.M. did little to change the bankruptcy landscape, save for alerting the public to the reality that is modern Chapter 11 practice."[98] The main question debated by Professors Roe and Skeel, on the one hand, and Professor Lubben, on the other, is whether the Chrysler and GM bankruptcies represent a watershed that has the capacity to change the Chapter 11 process (Roe and Skeel) or whether Chrysler and GM are just one among a series of similarly situated § 363 sale cases over a ten-year period (Lubben). Neither side in the debate appears to be conceding.

In the world of corporate finance, however, it may be of no moment whether Professor Lubben is correct in his observations and analysis or whether Professors Roe and Skeel have the better argument. In accordance with the semi-strong version of the efficient capital market hypothesis, the market reacts to publicly available information,[99] and the overwhelming tenor of publicly available

[96] Stephen J. Lubben, *A Bankruptcy Sale That Echoes G.M. and Chrysler*, N.Y. TIMES DEALBOOK (Sept. 28, 2010, 3:47 PM), http://dealbook.blogs.nytimes.com/2010/09/28/a-bankruptcy-sale-that-echoes-g-m-and-chrysler.

[97] *Id.* No doubt Professors Roe and Skeel would characterize the Claim Jumper Restaurant proceeding as evidence of their foretold change in Chapter 11 practice heralded by the Chrysler and GM cases.

[98] *Id.*

[99] Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 176–77 (2006).

> The Efficient Capital Market Hypothesis (the ECMH) posits that efficient securities markets rapidly and accurately incorporate all relevant available information into the market price of any given security. The theory assumes that market prices react immediately to each new bit of public information that becomes available, and therefore, the price of securities is always a reflection of their fair, intrinsic value.

*Id.* (footnotes omitted).

information regarding the Chrysler and GM bankruptcies indicates that certain creditors with bargained-for priority positions were unfairly disadvantaged in the process in a manner inconsistent with the letter or intent of the Chapter 11 process.[100] Moreover, different U.S. Circuit Courts of Appeal have different ways of preventing reorganization plans from being effectuated through a § 363 sale, creating the real possibility for unequal treatment among the different circuits.[101] It may be the appearance or perception of unfairness or inequity that creates market effects, rather than any reality that may be ascertainable by legal scholars or bankruptcy practitioners. Accordingly, absent congressional or judicial clarity, consistency and transparency about the extent to which a § 363 sale can adjust the priority position of creditors in Chapter 11 proceedings may provide some relief from adverse market effects by giving the process an air of predictability.

Yet this consistency and transparency may be hard to achieve when the federal government (as an actual or potential investor), as well as Article II and Article III judges, has power over a debtor's reorganization plan. The government can be a game-changer. In short, "[a]lthough the U.S. government rarely steps in to rescue private enterprises, it wields enormous power and influence when it does."[102] Many therefore may wonder, as Professor Todd Zywicki did in his passionate opinion piece for *The Wall Street Journal*,[103] whether the government's leverage creates more long-lasting effects on the rule of law as it relates to corporate finance.

> By stepping over the bright line between the rule of law and the arbitrary behavior of men, President Obama may have created a thousand new failing businesses. That is, businesses that might have received financing before but that now will not, since lenders face the potential of future government confiscation. In other words, Mr. Obama may have helped save the jobs of thousands of union workers whose dues, in part, engineered his

[100] Interestingly, however, some major financial players are cautiously optimistic that secured lenders are not in peril. *See Moody's: Secured Lenders Shouldn't Fear Chrysler Precedent*, N.Y. TIMES DEALBOOK (June 22, 2009, 6:05 PM), http://dealbook.blogs.nytimes.com/2009/06/22/moodys-secured-lenders-shouldnt-fear-chrysler-precedent.

[101] *See* Lubben, *supra* note 82, at 533–34.

[102] James M. Lawniczak, *When the Business of Government Is Business: The U.S. Auto Industry and the Future of Government Bailouts*, J. CORP. RENEWAL, Mar. 26, 2010, *available at* http://www.turnaround.org/Publications/Articles.aspx?objectId=12653.

[103] Todd J. Zywicki, *Chrysler and the Rule of Law*, WALL ST. J., May 13, 2009, at A19.

> election. But what about the untold number of job losses in the future caused by trampling the sanctity of contracts today?[104]

Along similar lines, Professor Benjamin Templin has expressed policy concerns emanating from constitutional principles and political economic theory.

> The Obama administration's political maneuvering violated the spirit of the U.S. Constitution given the implicit moral principles supporting contract and property rights found within the document. From a political economy perspective, Government interference with contractual and property rights fundamentally opposes one of the four primary institutional norms of a successful entrepreneurial economy. If entrepreneurs cannot rely on the support of the government to enforce contractual rights, then they will be less willing to take risks in starting new companies.[105]

Professor Templin goes on to validate specifically the concern raised in this Part that the government's heavy-handed intrusion in the Chrysler bankruptcy process has the propensity to impact capital markets.

> The government led effort that reduced bondholder rights is expected to make the private equity firms more cautious about lending money to politically powerful companies. Future lenders to such firms will be wary of whether their investment will be protected during a potential bankruptcy. The cost of capital for such companies will rise in such circumstances making them less competitive with foreign car companies.[106]

And Professor Richard Epstein adds his voice to the robust chorus.

> The entire structure of large credit markets . . . depends on following the rules of the game to the letter. We have already seen that market melt down. Add in bad bankruptcy rules and the risks get larger. Memories are long in credit markets, and in the worst-case scenario the pricing of every major deal could be impacted if deviant bankruptcies become the norm. Let's hope that Chrysler and GM prove to be one-off concoctions borne of desperation. But don't bet on it yet.[107]

So far, capital markets have survived the Chrysler and GM bankruptcies. The actual long-term effects of the U.S. government's

---

[104] *Id.*

[105] Templin, *supra* note 49, at 44 (footnotes omitted).

[106] *Id.* at 45 (footnotes omitted).

[107] Richard A. Epstein, *Political Bankruptcies: How Chrysler and GM Have Changed the Rules of the Game*, FREEMAN, Dec. 2009, http://www.thefreemanonline.org/featured/political-bankruptcies-how-chrysler-and-gm-have-changed-the-rules-of-the-game.

directorial role in these Chapter 11 proceedings on corporate finance remain to be seen. However, economic theory and analysis portend possible shock waves in the capital markets, in particular if participants in corporate finance transactions suffer or perceive unchecked violations of the legal or normative rules of engagement. Every investor knows that issuers get to re-write financial instruments in Chapter 11; but they also have a sense of how far that process can go. At some level of unpredictability, the players will inevitably lose confidence and leave the game.

## IV. REGULATION THROUGH INFLUENCE OVER MERGER AND ACQUISITION ACTIVITY

The U.S. government's influence over two key crisis-driven mergers—as a shadow investor of sorts[108]—is further evidence of its regulation through corporate finance. As the guarantor of a last-minute, short-term loan by JPMorgan Chase & Co. (JPMorgan) to Bear Stearns Co. (Bear Stearns), the Federal Reserve Bank of New York essentially brokered and compelled the sale of Bear Stearns to JPMorgan in March 2008.[109] Similarly, the Federal Deposit Insurance Corporation (FDIC) used its regulatory control over Wachovia Corporation (Wachovia), supported in the end by favorable decisions of the Federal Reserve Board and the Federal Trade Commission, to (eventually) ordain the acquisition of Wachovia by Wells Fargo & Company (Wells Fargo), even though the FDIC initially supported Citigroup's bid for Wachovia.[110]

Absent this unorthodox federal intervention, each of these transactions, effectuated by ordinary, state-law mergers, typically would be privately negotiated and documented to comply with laws of the states of incorporation of the parties, the law governing the

[108] Professors Davidoff and Zaring describe the government's role in the JPMorgan/Bear Stearns merger as "a deal-making middleman, a traditional role for investment bankers." Davidoff & Zaring, *supra* note 2, at 538.

[109] *See* DAVIDOFF, *supra* note 1, at 138–39; Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713, 717–18 (2009); Edward Pekarek & Michela Huth, *Bank Merger Reform Takes an Extended Philadelphia National Bank Holiday*, 13 FORDHAM J. CORP. & FIN. L. 595, 695 (2008); Templin, *supra* note 49, at 89; Robin Sidel et al., *J.P. Morgan Buys Bear in Fire Sale, As Fed Widens Credit to Avert Crisis*, WALL ST. J., Mar. 17, 2008, at A1.

[110] *See* DAVIDOFF, *supra* note 1, at 260–63; Frank A. Hirsch, Jr. & Joseph S. Dowdy, *Whither Wachovia? Wells Fargo Wins The Battle For The Storied North Carolina Banking Institution*, 13 N.C. BANKING INST. 167, 169, 177-80 (2009); Press Release, Associated Press, Fed Approves Wells Fargo's Wachovia Acquisition (Oct. 12, 2008), *available at* http://www.foxnews.com/story/0,2933,436661,00.html.

various aspects of the transaction, applicable stock exchange rules, and other pertinent bodies of regulation (including, in these two cases, federal securities regulation, antitrust regulation, and banking regulation). There are indicia of customary corporate finance transactions in both mergers. For example, the JPMorgan/Bear Stearns transaction included a stock lock-up (albeit on somewhat non-standard terms).[111] The Wells Fargo/Wachovia transaction included a purchase by Wells Fargo of a new series of Wachovia voting-preferred stock in exchange for shares of Wells Fargo common stock.[112] Each merger agreement included a "force-the-vote" provision (which required, in each case, repeated submissions of the merger to shareholders for a vote over a fixed period of time).[113]

Yet, the Bear Stearns and Wachovia mergers jumbled the typical separation of market-driven agreements on normative terms and the regulatory overlay for the transaction. For example, the U.S. Department of the Treasury (Treasury Department) refused to finance an acquisition of Bear Stearns by J.C. Flowers & Co. LLC, preferring instead to push JPMorgan to offer Bear Stearns a low price (as a way of impeding future moral hazard in the financial services sector) and accept related financial assistance.[114] In the case of Wachovia, the Chairman of the FDIC selected the initial favored acquiror (Citigroup) and allowed for the intervention of the eventual-blessed acquiror (Wells Fargo).[115] Neither transaction occurred in a typical arm's length environment, and neither transaction complied with the elements of good corporate finance procedures for approvals undertaken for financial institution mergers

---

[111] *See* DAVIDOFF, *supra* note 1, at 142–43; Kahan & Rock, *supra* note 109, at 718.

[112] *See* DAVIDOFF, *supra* note 1, at 261. This preferred stock issuance relied on blank check authority in Wachovia's articles of incorporation (as a North Carolina corporation) and (according to the related agreement) a waiver of the NYSE shareholder approval rule. *See id.* at 261. *See generally supra* Parts II.A & B (discussing blank check authority and the NYSE shareholder approval rule, respectively). On the latter point, however, I note that the new series of preferred stock (Series M) is not convertible into common stock and (therefore) may not have triggered shareholder approval requirements under the NYSE rule. *See* Wachovia Corp., Articles of Amendment (Form 8-K) at Ex. 3.1 (Oct. 10, 2008), *available at* http://www.sec.gov/Archives/edgar/data/36995/000119312508213052/dex31.htm (Articles of Amendment establishing the Series M, Class A preferred Stock); *supra* note 35 and accompanying text.

[113] *See* DAVIDOFF, *supra* note 1, at 141, 261.

[114] *See id.* at 139; Pekarek & Huth, *supra* note 109, at 605; Robert J. Rhee, *Fiduciary Exemption for Public Necessity: Shareholder Profit, Public Good, and the Hobson's Choice During a National Crisis*, 17 GEO. MASON L. REV. 661, 682 (2010).

[115] *See id.* at 261–62.

and acquisitions *outside* a financial-crisis environment.[116] Shareholder allegations of unlawful terms and breaches of fiduciary duty ensued.[117]

This intermixing of public regulation and private deal-making disrupts the market for corporate control.[118] In theory, members of the acquiror's and target's management, not government regulators, are the best-equipped people to negotiate a full and fair price and appropriate terms for the benefit of the target's shareholders when the target is to be sold.[119]

> The key question . . . is whether the government or some governmentally appointed agent of the public interest can distinguish, in advance, between individual transactions that will be good and those that will be bad for the economy. Can the government determine whether a merger will work out in the efficient and profitable way that the parties are betting it will? We think it is clear that the government is incapable of making that judgment.[120]

By forcing transactions, picking transaction partners, and defining or constraining transactional terms, the U.S. government may be mandating or fostering business combination transactions, capital structures, and management teams that do not enhance shareholder value or provide additional benefits to other corporate constituencies. Consider, for example, the Treasury Department's

---

[116] *See* Memorandum from Fried, Frank, Harris, Shriver & Jacobson LLP, Courts Uphold Sales of Wachovia and Bear Stearns: What the Financial Crisis Has Brought Together, Let No Judge Put Asunder (Jan. 9, 2009), *available at* http://www.ffhsj.com/siteFiles/Publications/195087EE5830C30A790D5B34530FF2EC.pdf.

[117] *See* Hirsch & Dowdy, *supra* note 110, at 181–91; Kahan & Rock, *supra* note 109, at 720–21.

[118] Jonathan R. Macey, *The Politization of American Corporate Governance*, 1 VA. L. & BUS. REV. 10, 25–26 (2006) ("The market for corporate control is a pure market process. Government intervention is not needed to correct structural defects in this market. Rather, regulatory intervention, when it occurs, reflects the efforts of special interest groups . . . ."); Richard S. Ruback, *Law and Economics: An Economic View of the Market for Corporate Control*, 9 DEL. J. CORP. L. 613, 613–14 (1984) ("The market for corporate control is the arena in which management teams compete for the right to manage resources. In this managerial competition model of the market for corporate control, management teams are the activists . . . .") (footnote omitted).

[119] *Id.* at 616 ("Ignoring conflict of interest problems, the evaluation by the incumbent management team is most efficient since they are likely to have the best information set. Since the incumbent management team typically wants to retain its position, it is unlikely that it would approve a merger at less than the full value of the target firm.").

[120] Douglas H. Ginsburg & John F. Robinson, *The Case Against Federal Intervention in the Market for Corporate Control*, BROOKINGS REV., Winter/Spring 1986, at 9, 11.

low-price mandate in the JPMorgan/Bear Stearns merger.[121] The government's involvement suppressed market-based competition between management teams. As a result of shareholder and employee dissatisfaction with the low deal price, JPMorgan increased the merger consideration from two dollars per share to ten dollars per share.[122] Of course, these facts evidence both the lack of market involvement in the initial price setting and the market's eventual, albeit limited, power (through shareholder intervention) to force price modification.

The government's influence in the Bear Stearns and Wachovia transactions represents a rare, but non-exclusive, way in which government impacts the market for corporate control.[123] Through antitrust, securities, and corporate law, federal and state governments routinely rebalance the market for corporate control. Yet as is true in the Chapter 11 context addressed in Part III of this Article, the federal government's influence as a non-regulatory player in mergers and acquisitions transactions is less transparent and predictable, raising concerns about potential effects on broad markets and the potential for opportunistic abuses of power.

## V. CONCLUSION

> In the government's actions are . . . lessons for deal-making and deals. It is an incredible illustration of the potential for deal-making. In pushing the limits of the law, the government has created precedent for extreme deal-making situations. This is precedent not only for future government action to stem systemic panic, but also for private dealmakers structuring deals.[124]

The U.S. government's investment in private enterprise in response to the financial crisis provides valuable opportunities to make important observations useful to corporate finance practice. For example, the U.S. government's preferred stock purchases highlight the utility of blank check preferred stock as an essential predicate to last-minute equity financings while at the same time casting light on drafting weaknesses in charter provisions conferring

[121] *See supra* note 114 and accompanying text.

[122] *See* DAVIDOFF, *supra* note 1, at 146; Pekarek & Huth, *supra* note 109, at 697.

[123] *See* George Bittlingmayer, *The Market For Corporate Control (Including Takeovers)*, *in* ENCYCLOPEDIA OF LAW & ECONOMICS 725, 732 (Boudewijn Bouckaert & Gerrit De Geest eds. 1996–2000), *available at* http://encyclo.findlaw.com/5640book.pdf ("The federal government may interfere with the transfer of control on various grounds.").

[124] *See* DAVIDOFF, *supra* note 1, at 247.

blank check authority. Moreover, exceptions to the NYSE shareholder approval rules granted to AIG (and others) afford us with more information about the confluence of circumstances that may excuse the need for stockholder approval of large stock issuances. In addition, the varied terms of the U.S. government's preferred stock investments constitute a prominent reminder of the relatively flexible, contractual nature of preferred stock as a financing and regulatory tool. It is incumbent upon and beneficial to drafters of corporate finance instruments to harness this flexible tool in service of the client.

Similarly, the U.S. government's interference in private enterprise during the financial crisis offers us opportunities to reflect on interconnections between bankruptcy process and corporate finance—or more specifically, capital markets. The costs associated with the short-form § 363 sales used in the Chrysler and GM bankruptcies may discourage capital investment. The reality of these costs may be less important than the public perception of them in creating adverse market effects. Accordingly, absent changes in the law that curtail or prevent the re-writing of the process involved in § 363 sales, enhanced consistency in and transparency about the appropriate use of the § 363 sale process by and at the behest of the U.S. government and others will be necessary to minimize market disruptions. Corporate finance counsel are well advised to understand the bankruptcy process in representing both issuers and investors, so that bankruptcy risk may be more accurately assessed and priced.

Finally, the U.S. government's influence over private enterprise during the financial crisis disrupts the market for corporate control that drives a segment of the mergers and acquisitions market. By interceding in what otherwise would be privately negotiated mergers and acquisitions, the U.S. government challenges mergers and acquisitions law and norms and changes the nature of mergers and acquisitions practice. Governmental interventions in mergers and acquisitions may result in mispriced, mistimed, or otherwise suboptimal transactions and may perpetuate or proliferate the kind of poor corporate management and substandard stock performance that contributed to the severity of the financial crisis.

The bottom line? The U.S. government both used and subverted corporate finance instruments and transactions in rescuing numerous systemically important firms during the recent financial crisis. As a result, corporate finance drafting and practice has been thrust into the spotlight. The high visibility of corporate finance drafting and practice enables us to more clearly identify and correct flawed or inferior provisions in corporate finance instruments and contracts, to better evaluate the need for shareholder approvals in difficult economic times and for specific issuers, and to focus on the creative use of the malleable, contractual nature of preferred stock in non-normative and normative corporate finance situations. In addition, federal incursions into bankruptcy and mergers and acquisitions practice are forcing corporate finance scholars and practitioners to rethink both the theory and practical realities of corporate finance in these contexts.

The overall presence of the federal government as a player in the game of corporate finance also has broader ramifications. Investor confidence in our capital markets depends, in part, on the certainty and predictability of corporate finance instruments and transactions. As examples included in this Article and elsewhere illustrate, U.S. government investment and interference in and influence over private enterprise decreases this certainty and predictability. A lack of consistency and transparency enhances this effect.[125] "Government by deal at times appeared to reduce confidence in the markets."[126] More significant or long-term government participation in corporate finance transactions—in

[125] *See* Barbara Black, *The U.S. as a Reluctant Shareholder: Government, Business, and the Law*, 5 ENTREPRENEURIAL BUS. L.J. (forthcoming 2010) (manuscript at 28–29), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1646943 ("[M]embers of the public understandably want greater transparency, in order to assess for themselves how these uneasy alliances between government and business are working out."). Transparency may be especially important where the government is a shareholder.

> In a corporation in which the government has taken a substantial equity interest, however, members of the general public have reason for concern, for this is an extraordinary situation in which all U.S. taxpayers have a sizable stake. It is also understandable that, given the unusual situation, the public would be confused or mistrustful of government intervention. Under these circumstances, the government should work with management for maximum transparency consistent with protecting the corporation's legitimate needs for confidentiality.

*Id.* at 29.

[126] DAVIDOFF, *supra* note 1, at 269. Professor Templin also makes this point:

> If the state, rather than market forces, determines winners and losers, some firms gain a competitive edge not based on efficiency and prudent management but on political influence and bargaining. Such political interference can have consequences for the political economy as a whole since private investors may become reluctant to participate in some ventures if they know the state is going to interfere.

Templin, *supra* note 49, at 38–39 (footnote omitted).

whatever form or forms it may take—may have a destabilizing effect on capital markets and therefore should not be undertaken lightly.